

Members

Sen. Greg Walker, Chairperson
Sen. R. Michael Young
Sen. Lindel Hume
Sen. Karen Tallian
Rep. Woody Burton
Rep. Jeffery Thompson
Rep. David Niezgodski
Rep. Win Moses
Steve Meno
Kip White
Gary Lewis
James Scheetz



PENSION MANAGEMENT OVERSIGHT COMMISSION

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MEETING MINUTES¹

Meeting Date: September 28, 2011
Meeting Time: 1:00 P.M.
Meeting Place: State House, 200 W. Washington St., Room 431
Meeting City: Indianapolis, Indiana
Meeting Number: 2

Members Present: Sen. Greg Walker, Chairperson; Sen. R. Michael Young; Sen. Karen Tallian; Rep. Woody Burton; Rep. Jeffery Thompson; Rep. David Niezgodski; Steve Meno; Kip White; Gary Lewis; James Scheetz.

Members Absent: Sen. Lindel Hume; Rep. Win Moses.

Call to Order

The Chair, Senator Walker, called the second meeting of the Pension Management Oversight Commission (PMOC) to order at approximately 1:05 p.m.

Defined Benefit (DB) Plans and Defined Contribution (DC) Plans

The Chair recognized Al Gossard, Deputy Director, Office of Fiscal and

¹ These minutes, exhibits, and other materials referenced in the minutes can be viewed electronically at <http://www.in.gov/legislative>. Hard copies can be obtained in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for hard copies may be mailed to the Legislative Information Center, Legislative Services Agency, West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for hard copies.

Management Analysis, Legislative Services Agency (LSA). Mr. Gossard summarized a memorandum prepared by LSA which compares DB and DC pension plans. (Exhibit 1). A DB plan is a pension where the benefit payment formula is predetermined. A DC plan is a pension where the employee or employer contributes a fixed dollar amount or percentage of salary into an account to be used, in combination with accrued earnings, to pay benefits at retirement.

Mr. Gossard described four differences between a DB plan and a DC plan: (1) vesting requirements; (2) cost-of-living adjustments (COLA); (3) risk and predictability; and (4) adverse selection.

Commission members then discussed the effects on public pension plans when the State does not adequately fund them.

The Chair recognized Steve Russo, INPRS Executive Director, who briefly discussed the history of public pensions. He described how pensions developed over time and became an incentive for recruiting and retaining employees.

Mr. Russo then turned the presentation over to Cindy Fraterrigo of Price Waterhouse Coopers, actuary for the Indiana Public Employees' Retirement Fund (PERF), and John Dowell of Nyhart Company, actuary for the Indiana State Teachers' Retirement Fund (TRF). Staff distributed to members of the Commission a copy of "Analysis of Proposed Optional DB to DC, Review with PMOC". (Exhibit 2).

Ms. Fraterrigo began by discussing the assumptions used in a hypothetical option for INPRS members to voluntarily convert their DB benefits to a DC plan. The assumptions included the following:

- (1) All active members of the PERF and TRF plans will have a one-time, irrevocable option of moving from a DB plan to a DC plan.
- (2) Employer contributions assumed to approximate normal cost of DB plans.
- (3) The member contributions equal three percent.
- (4) The present value of the accrued benefit in the DB plan will be transferred to the DC plan as an opening DC plan balance.
- (5) The transfer value of the DB accrued benefit differs from the current funding liability.
- (6) Any additional funding required to fully fund the opening DC balance will require a one-time contribution from either the employer or the State.

Ms. Fraterrigo then explained that there are other options for converting from a DB plan to a DC plan. She indicated that another option would be to freeze the DB account and provide a fresh start in a DC plan. In this scenario, the member would receive both a DC and a reduced DB benefit.

Commission members discussed other states which have converted DB plans into DC plans.

Ms. Fraterrigo then made the following observations regarding the hypothetical voluntary conversion from a DB plan to a DC plan by INPRS members:

- (1) A member's decision to choose between a DB and DC plan will be driven primarily by when the member expects to terminate employment.
- (2) For a member who expects to stay until retirement age, staying with the DB plan is preferable.
- (3) For a member who expects to leave employment prior to retirement age, moving to a DC plan is preferable.
- (4) Varying other assumptions like age at death and DC investment returns also impacts which is the most beneficial option.
- (5) In general, a small percentage of public employees opt to convert from a DB to a DC plan.
- (6) DC plans place the risk on the members and yield lower retirement benefits per unit of costs.
- (7) If members choose the best economic benefit based on the length of time they expect to work with the employer, this will add cost to the employer.
- (8) The funding of the remaining DB deficit will remain as long as a conversion to a DC plan is optional for members.
- (9) Studies indicate a DC plan generally costs 20-25% more over time than a DB plan that provides similar retirement benefits. Conversely, DC plans generally provide 20-30% lower benefits than DB plans at retirement ages for similar costs.

The Commission members discussed an employee's options to protect their DC benefit during an economic downturn.

Ms. Fraterrigo described the following advantages to employers by offering employees the option to transfer to a DC plan:

- (1) Improved cost stability because there is no unfunded liability or cost volatility for DC members.
- (2) The employer no longer bears the risk of investment returns, longevity of members, and inflation or salary increases for members electing the DC plan.
- (3) Since members will need to be educated about DB or DC choices, it will create a better understanding of employee's retirement benefits.

Ms. Fraterrigo then described the following disadvantages to employers:

- (1) If members choose the most economic benefit for themselves, there will be increased cost to employers with the remaining DB plan participants.
- (2) There will be less flexibility for managing the workforce.

Senator Tallian asked why the DC plans cost more. Ms. Fraterrigo responded that there are various factors affecting the cost, including; the way benefits are computed; investment choices may be more conservative and returns will be lower;

and the investment costs are more expensive.

Ms. Fratterrigo then provided the following additional considerations when determining whether to offer employees the option to transfer from a DB to a DC plan:

- (1) DB benefits generally offer spousal survivor benefits and it may be beneficial to require spousal consent to transfer to a DC plan.
- (2) Providing disability or death protection for DC members.
- (3) Allowing loans from the DC plan and the potential impact on retirement savings.
- (4) The economic and societal impacts of moving to only DC plans are still unknown. For example, what happens if a retiree uses up their DC retirement benefits.

The Chair then recognized Doug Todd of McCready and Keene, who provided a general comparison of DB and DC plans. Mr. Todd summarized a handout which he distributed to the Commission. (Exhibit 3). He briefly described the following issues that an employer should keep in mind when comparing a DB plan and a DC plan:

- (1) Investment risk.
- (2) How benefits accrue.
- (3) Portability.
- (4) Design issues.
- (5) Death and disability.
- (6) Flexibility.

The Chair recognized Tom Hanify, President of the Professional Firefighters Union of Indiana and Tim Downs, President of the Fraternal Order of Police. Mr. Hanify and Mr. Downs provided a PowerPoint presentation and provided a handout. (Exhibits 4 and 5).

Mr. Hanify began by complimenting INPRS on its management of the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund). Mr. Hanify summarized five functions of the 1977 Fund. They include:

- (1) providing a temporary disability benefit for disabled police officers and firefighters who will recover and return to full duty;
- (2) providing a long term disability benefit for disabled police officers and firefighters who are permanently unable to return to duty;
- (3) providing a death benefit for surviving spouses and children;
- (4) providing a retirement pension; and
- (5) providing a pension for surviving spouses and children.

Mr. Downs then provided a brief history of public safety pensions in Indiana. He began by describing the Bowen Merrill Fire in Indianapolis which killed 13 firefighters on March 17, 1890, and how their families received no benefit or compensation. He went on to describe how Indiana's early public safety pensions developed into the current 1977 Fund.

Mr. Hanify provided testimony that the 1977 Fund is a well governed pension. He explained that the 1977 Fund does not allow "spiking" because the 1977 Fund

pays retirement based on a patrolman or private's salary. Spiking is the process where an employee receives pay increases immediately preceding retirement, which inflates the employee's retirement benefit. He then discussed how, in 1990, the General Assembly made disability benefit changes to account for degrees of disability. In 2010, the General Assembly made changes to the physical and mental pre-employment testing requirements to keep the 1977 Fund financially sound.

Mr. Hanify provided three examples to show how firefighters or police officers will be affected if they convert their DB plan to a DC plan. He stated that the spouse of Scott Davis, a firefighter killed in the line of duty, who is currently entitled to a \$53,124.96 DB benefit, would likely receive \$5,692.25 if the benefit was converted to a DC plan. The spouse of Brent Long, a police officer killed in the line of duty, is entitled to receive \$48,090.80 under the current plan, however, she would receive \$5,851.34 if the plan was converted to a DC lifetime annuity. Jason Fishburn, a police officer disabled in the line of duty, currently receives \$50,034.65. Mr. Hanify stated that he would receive \$9,043.05 if that benefit was converted to an equivalent DC lifetime annuity.

The Chair recognized Ken Gilliam, President of the Indiana Association of Fire Chiefs, and Chief Konzen of the Wayne Township Fire Department in Marion County. Chief Gilliam discussed the cost of recruiting qualified applicants and the cost associated with new employees. Chief Konzen explained the increased mental and physical stress associated with public safety jobs and testified that the current pension helps with recruitment.

Bryan Shearer, representing the Indiana Association of Chiefs of Police, testified that the current retirement plan is a valuable tool in the recruitment and retention of new employees.

Tom Miller of the International Association of Firefighters testified that the 1977 Fund well managed and is envied across the country.

The Chair then recognized Phil Troyer of NRP Financial Inc. and NRP Advisors, Inc. Mr. Troyer presented a handout and PowerPoint presentation. (Exhibits 6 and 7). Troyer explained that the number of private DB pension plans is declining because of longevity risk, investment risk, and cost. He noted that, from 2001 to 2010, the number of individuals who received PERF benefits for more than 25 years increased from 311 to 1,013. He also testified that to catch up from the prior decade's shortfall, PERF's consolidated retirement investment fund would have to triple its actual market value in this decade.

Mr. Troyer discussed the smoothing of the investment assets. He testified that according to PERF's former actuary, the funded ratio as of July 1, 2008, was 97.5%. Between July 1, 2008, and June 30, 2009, the market value of PERF's assets declined by \$3,055,900,000 or 20.6%. However, according to PERF's Annual Comprehensive Financial Report, PERF's actuaries claimed the funded ratio as of July 1, 2009, stood at 93.1%. He concluded that if the actual market value of the PERF assets were used, the funded ratio actually fell to 69.9%.

Mr. Troyer stated that the cost of operating the funds administered by INPRS in 2010 was \$153,737,000. He then stated that PERF's consolidated retirement investment fund paid \$75,801,000 in investment expenses in 2010 while the total amount of benefits paid was \$77,819,000.

Mr. Troyer then stated that a DC plan benefits taxpayers by transferring the longevity risk, investment risk, and cost to the employee. He suggested that his firm could assist the General Assembly in conducting a survey of the cost of converting the existing pension program to a cash balance account or transferring the state's existing pension liabilities to a private insurance company.

The Chair recognized Nancy Pappas, representing the Indiana State Teachers' Association. She stated that teachers and school employees already participate in local DC plans and that she was fearful of converting DB plans to DC plans. Ms. Pappas expressed her confidence in the current management of the TRF and encouraged additional study of this issue before making any changes.

Emma Hawkins, representing the Indiana State Employees' Association, testified that she was concerned that the elimination of the DB plan would eliminate the 13th check.

Andy Thomas, representing the Indiana Retired Teachers' Association, testified that he is very concerned about educating employees about managing their DC plan. He questioned whether an optional transfer to a DC plan would save any money or solve anything. He stated that DC plans for new employees won't help with current unfunded liabilities. Mr. Thomas also expressed concern about shifting risk to employees.

Adjournment

The Chair announced that PMOC will meet on October 25, 2011. He adjourned the meeting at approximately 5:00 p.m.